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ACTION EUR-12

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DEPARTMENT PASS FRB FOR KICHLIN AND FRANKEL,
TREASURY FOR GRIFFIN

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SUBJECT: COMMITTEE ON FINANCIAL MARKETS, MEETING
JULY 1-2, 1976

REFS: (A) CMF(76)14, (B) CD/EDS(76)4, (C) STATE 163056

1. SUMMARY: COMMITTEE ON FINANCIAL MARKETS (CFM) MET
JULY 1-2, 1976 FOLLOWING HALF DAY RESTRICTED SESSION
WITH PRIVATE BANKERS ON JUNE 30. CONSENSUS ON DEVELOPED
COUNTRY CAPITAL MARKETS WAS THAT WHILE THERE WOULD BE NO
PROBLEM WITH AVAILABILITY OF CREDIT THROUGH REMAINDER OF
1976, THERE WOULD BE SOME UPWARD PRESSURE ON INTEREST
RATES. CFM DIRECTED SECRETARIAT TO PREPARE STUDY ON
TRADING IN OPTIONS ON SECONDARY MARKETS AND TO FINISH
COUNTRY NOTES ON REGULATIONS IN EUROMARKETS. NEXT MEET-
ING OF EXPERTS ON ENTERPRISE FINANCING WILL BE HELD
SOMETIME DURING FALL, 1976. CFM CONSULTANT (REVELL)
DIRECTED TO PROCEED WITH INITIAL ASPECTS OF STUDY ON
COSTS OF INTERMEDIATION. CFM AGREED TO PLACE ON AGENDA
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FOR NEXT MEETING US INITIATIVE ON IDENTIFYING AND

REMOVING RESTRAINTS TO INTERNATIONAL PORTFOLIO CAPITAL FLOWS. NEXT CFM MEETING SCHEDULED FOR NOV. 4-5, 1976, WITH RESTRICTED BANKERS MEETING TO BE HELD AFTERNOON OF NOV. 3. END SUMMARY.

2. BANKERS MEETING: CHAIRMAN REPORTED ON RESTRICTED MEETING WITH GROUP OF PRIVATE BANKERS HELD AFTERNOON JUNE 30. BANKERS INDICATED NO CONCERN ABOUT AVAILABILITY OF CREDIT FOR MOST LDC BORROWERS IN DEVELOPED COUNTRY AND EURO- CAPITAL MARKETS. NO GREAT PRESSURE IS EXPECTED FROM BUSINESS BORROWERS. ONLY SLIGHT TIGHTENING OF CREDIT IS EXPECTED LATER IN YEAR. CFM REINFORCED GENERAL VIEW OF BANKERS THAT THERE WOULD BE SOME UPWARD PRESSURE ON INTEREST RATES IN DEVELOPED COUNTRY CAPITAL MARKETS AS THE YEAR PROGRESSES, ASSOCIATED MAINLY WITH EXPECTED CONTINUED ECONOMIC EXPANSION. HOWEVER, CREDIT DEMANDS BY BUSINESS BORROWERS WERE EXPECTED TO BE LIMITED. EARLIER CONCERN OVER CROWDING OUT OF PRIVATE BORROWERS HAS EVAPORATED. SEVERAL MEMBERS SUGGESTED THAT ECONOMIC EXPANSION IN SOME MEMBER COUNTRIES WOULD PROBABLY BE LESS BUOYANT THAN HAD BEEN EXPECTED. WORLD BANK REP NOTED THAT NEGOTIATIONS WERE UNDERWAY WITH OPEC COUNTRIES FOR JOINT FINANCING OF DEVELOPMENT PROJECTS; HE AGREED TO REPORT ON STATUS OF THESE VENTURES AT NEXT MEETING OF CFM.

3. SECURITIES MARKETS: US REP RESPONDED TO TECHNICAL QUESTIONS RAISED BY SECRETARIAT REGARDING REMAINING UNRESOLVED PROBLEMS IN DEVELOPMENT OF CENTRAL SECURITIES MARKET AND VIABILITY OF STOCK EXCHANGES UNDER SUCH A SYSTEM. FRENCH DEL DESCRIBED PROPOSALS IN SEVENTH PLAN TO STIMULATE SAVINGS AND INVESTMENT IN DOMESTIC SECURITIES MARKETS. NUMBER OF MEMBERS NOTED GROWING WORLDWIDE INTEREST IN TRADING IN OPTIONS ON SECONDARY MARKETS. CFM DIRECTED SECRETARIAT TO PREPARE BACKGROUND PAPER ON THIS SUBJECT FOR REVIEW AT FIRST MEETING IN 1977.

4. FOREIGN EXCHANGE MARKETS: CFM CONCENTRATED MAINLY ON TECHNICAL ISSUES HAVING TO DO WITH INTERVENTION POLICY IN SPOT AND FORWARD MARKETS. SWISS INTERVENTION LIMITED OFFICIAL USE

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TECHNIQUES WERE DISCUSSED AT SOME LENGTH. SECRETARIAT QUESTIONED EXTENT TO WHICH SWISS CENTRAL BANK COULD CONDUCT SUPPORT OPERATIONS THROUGH COMMERCIAL BANKS WHEN LATTER WISHED TO REFRAIN FROM BEING LOCKED INTO FROZEN SWISS FRANK ASSETS AT A TIME WHEN CENTRAL BANK TAKES STEPS TO NEUTRALIZE MONETARY IMPACT OF INFLOWS. SWISS REP AGREED PROBLEM TENDS TO SHIFT EXCHANGE DEALINGS ABROAD. FRENCH REP NOTED THAT EURO FRANC MARKET WAS

EXTREMELY THIN, CAUSING EXAGGERATED MOVEMENTS FROM EVEN
RELATIVELY SMALL CHANGES IN DEMAND OR SUPPLY PRESSURES.
UK REP REPORTED \$3.4 BILLION LOSS OF RESERVES DURING
MARCH-MAY PERIOD: OF THIS, ONE-THIRD DUE TO LEADS AND
LAGS, ONE-THIRD TO REDUCTION IN STERLING BALANCES, ONE-
SIXTH DUE TO CURRENT ACCOUNT DEFICIT, ONE-SIXTH DUE TO

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STERLING LENDING ABROAD. CHANGES IN BALANCES WERE
MOSTLY IN OFFICIAL HOLDINGS, WITH NO LEADING ROLE BEING
TAKEN BY ANY ONE OFFICIAL HOLDER. NOTED THAT UK BANK
LENDING ABROAD CONTINUED TO BE HIGHLY RESTRICTED, OVER
80 PERCENT BEING RELATED TO UK EXPORTS. SECRETARIAT
QUESTIONED "BEAR SQUEEZE" ON SHORT TERM SPECULATORS
WHICH WAS BROUGHT ABOUT BY CENTRAL BANK THROUGH SPOT-
FORWARD SWAP DEALS. UK REP STRESSED THIS TECHNIQUE ONLY
POSSIBLE FOR LIMITED PERIODS; ATTEMPT TO HOLD SQUEEZE
TOO LONG IN CURRENCY WITH LARGE NON-RESIDENT HOLDINGS
WOULD LEAD TO MOVEMENT OF FUNDS FROM DOMESTIC MARKET TO
EURO-STERLING MARKET. JAPANESE REP RESPONDED TO QUES-
TION ABOUT FOREIGN BORROWING IN JAPAN BY NOTING THAT

VERY LARGE NUMBER OF FOREIGN BORROWERS WISH TO RAISE FUNDS IN JAPAN, MAKING IT NECESSARY FOR AUTHORITIES TO

SELECT BEST BORROWERS. RESULT IS THAT FOREIGN GOVERNMENTS TEND TO OBTAIN LARGEST SHARE OF SUCH BORROWING. DUTCH REP NOTED THAT USE OF FORWARD SWAPS IN FOREIGN EXCHANGE MARKET TO INCREASE BANK DOMESTIC BANK LIQUIDITY WAS OFTEN PREFERABLE TO OPERATIONS IN SECONDARY LIMITED OFFICIAL USE

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MARKET IN DOMESTIC ASSETS, SINCE LATTER MARKET WAS POORLY DEVELOPED IN NETHERLANDS WHEREAS FOREIGN EXCHANGE MARKET WAS HIGHLY ACTIVE. MOST OPERATIONS INVOLVE SPOT PURCHASE AND FORWARD SALE OF DOLLARS WITH DOMESTIC BANKS, SINCE AUTHORITIES BELIEVED IT APPROPRIATE TO MAINTAIN LOWER INTEREST RATES FOR STRONG CURRENCY SUCH AS GUILDER.

5. EURO-CURRENCY MARKETS: EC REP INDICATED THAT HE WOULD PRESENT REPORT TO NEXT MEETING OF CFM ON NEWLY COMPLETED EC STUDY OF SHORT TERM CAPITAL MOVEMENTS THROUGH EURO MARKET AMONG EC MEMBER COUNTRIES. SECRETARIAT WILL ATTEMPT TO COMPLETE REMAINING COUNTRY NOTES ON REGULATIONS IN OECD COUNTRIES AFFECTING EUROMARKET OPERATIONS OF BANKS AND NON-BANKS IN TIME FOR NEXT CFM MEETING. THERE WERE NO PROPOSALS OR DISCUSSION FOR FURTHER REGULATION OF EURO CURRENCY MARKET.

6. ENTERPRISE INVESTMENT AND FINANCING: COUNTRY EXPERTS WERE ASKED TO PROVIDE CRITICAL ANALYSIS OF WORK ON THIS SUBJECT TO DATE. AD HOC GROUP OF EXPERTS IS EXPECTED TO HOLD TWO MEETINGS BEFORE EARLY 1977 IN ORDER TO COMPLETE PROJECT BY MID-1977. NEXT MEETING TENTATIVELY SET FOR SOMETIME IN OCTOBER, 1976, WITH DATE TO BE NOTIFIED DURING SUMMER.

7. COST OF INTERMEDIATION: CFM NOTED PROPOSED OUTLINE OF STUDY PROJECT BY PROFESSOR REVEL (REFA) TO DETERMINE COSTS OF INTERMEDIATION. CONSULTANT WILL NOW PROCEED WITH INITIAL ASPECTS OF STUDY (I.E., GATHERING OF STATISTICS). HOWEVER, SINCE NUMBER OF MEMBERS EXPRESSED RESERVATIONS ABOUT POSSIBILITY THAT STUDY MIGHT GET INTO AREAS OF BANKING AND CREDIT POLICY, CONSULTANT WAS DIRECTED NOT TO MOVE IN TO CONSIDERATION OF POLICY ISSUES.

8. EUROMARKET BORROWING BY DEVELOPING COUNTRIES: (SEE ALSO PARA 2 ABOVE): CFM NOTED REPORT (REF B) BY MR. WELLONS THIS SUBJECT WILL BE CONSIDERED DURING FORTHCOMING CONFERENCE ON BORROWING BY DEVELOPING COUN-

TRIES (SPONSORED BY OECD DEVELOPMENT CENTER JULY 21-23).
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CONFERENCE PARTICIPANTS WILL INCLUDE PRIVATE BARKERS.

9. RESTRAINTS ON INTERNATIONAL CAPITAL FLOWS: US REP
DISTRIBUTED NOTE ON US TREASURY SECRETARY SIMON PROPOSAL
THAT CFM BE CHARGED WITH IDENTIFYING VARIOUS IMPEDIMENTS
TO INTERNATIONAL FLOWS OF PORTFOLIO CAPITAL AND
ESTABLISHING A PROCEDURE FOR CONSULTATIONS WITH A VIEW
TOWARD REDUCING SUCH IMPEDIMENTS (REF C). CFM AGREED TO
PLACE QUESTION ON AGENDA FOR DISCUSSION AT NEXT MEETING,
BY WHICH TIME MEMBERS WOULD HAVE HAD OPPORTUNITY TO
CONSULT WITH THEIR GOVERNMENTS.
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